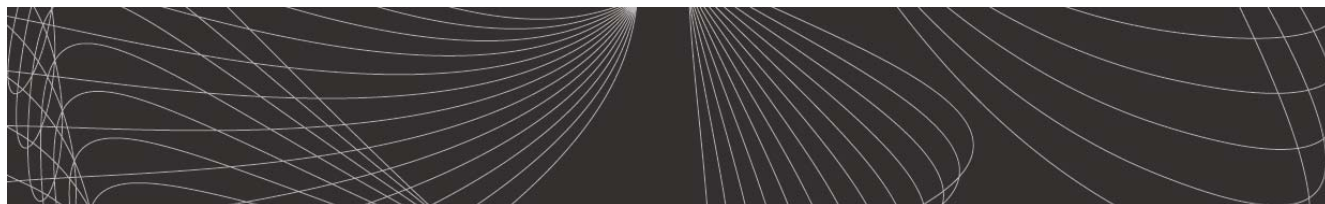




Library and Archives  
Canada

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Canada



# **AUDIT OF READINESS FOR THE IMPLEMENTATION OF THE POLICY ON INTERNAL CONTROL**

**AUDIT REPORT  
JUNE 2010**

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## EXECUTIVE SUMMARY

To meet the Policy on Internal Control requirements, departments and agencies are expected to develop, and execute annually, a plan to assess the effectiveness of their Internal Control over Financial Reporting (ICFR).

The purpose of this audit was to provide real-time insight and assurance for the readiness to implement the ICFR assessment process. Such an "under development" approach, common during the implementation of major initiatives, is intended to provide timely and constructive guidance to the Chief Financial Officer (CFO) while also providing assurance.

Accordingly, the audit has assessed the adequacy of processes and practices in place to support the deployment of the Policy on Internal Control (PIC) requirement to assess Internal Control over Financial Reporting related to external financial statements. The audit approach and methodology are contained in Appendix A and Appendix B.

The process for planning and conducting a risk-based assessment of the effectiveness of internal control over financial reporting is comprised of five phases:

Phase 1: Planning;

Phase 2: Evaluating entity-level controls;

Phase 3: Evaluating internal control at the transaction or process level;

Phase 4: Testing control design and operating effectiveness; and

Phase 5: Assessing results of testing, reporting and developing management action plans, and revising future annual and multi-year plans.

The ICFR assessment process is an iterative one; the pace and scope of which is risk-based. Information obtained through each phase regarding risks and the effectiveness of controls in place to mitigate risks is used to refine and adjust ICFR assessment plans for continued relevance. This helps ensure an appropriate focus on the areas of most significance to the integrity of the financial statements.

The assessment is that Library and Archives Canada has started the planning phase of the ICFR assessment process, and significant work is still required to implement the processes and practices needed to be able to complete the remaining phases of the assessment process and comply

with Policy on Internal Control requirements for the *Statement of Management Responsibility Including Internal Control over Financial Reporting* by 2011–2012.

The CFO has assigned the Manager, Financial Policies, Management Practices and Quality Assurance to lead the assessment planning process. Together, they are in the process of developing the risk-based approach.

This audit report provides recommendations to enable the planning and execution of the ICFR risk-based assessment plan, including:

- Developing a framework to guide the risk-based plan;
- Ensuring clear communication of roles and responsibilities to key internal parties who will support the Deputy Head (Librarian and Archivist of Canada) and the CFO in assessing and monitoring internal control over financial reporting;
- Applying risk-management practices to identify significant financial statement accounts and processes, key financial systems and processes;
- Selecting a control framework against which entity-level controls and IT general controls may be assessed;
- On a risk basis, documenting key entity-level controls, financial systems controls and process-level controls and testing for design and operating effectiveness;
- Defining training and awareness requirements to support key stakeholders in their roles and responsibilities for deploying the Policy on Internal Control.

Management has agreed and developed an action plan to address these recommendations.

## 1 INTRODUCTION

The Library and Archives Canada (LAC) Risk-Based Audit Plan (2009–2012) called for an audit of Readiness for the Policy on Internal Control to be conducted in 2009–2010. This audit report presents the outcome of the conduct of the audit from November 2009 to January 2010.

### 1.1 Audit Objective

The objective of this engagement was to assess the adequacy of the controls, processes and practices in place within LAC to implement the Policy on Internal Control and achieve the policy objective.<sup>1</sup>

### 1.2 Scope

The scope of the audit included the following integral elements as they relate to the deployment of the Policy on Internal Control at LAC.

- Governance and Accountability, including clarity of roles and responsibilities of various parties (e.g., CFO, senior managers, etc.) in relation to the policy requirements.
- Risk Management, emphasizing the controls in place to support an appropriate, risk-based identification of key financial reporting controls.
- Stewardship, emphasizing the processes in place across LAC for the testing and reporting on controls, in support of the *Statement of Management Responsibility Including Internal Control over Financial Reporting*.
- People, including necessary training, tools and resources to support various parties (CFO and other senior managers reporting to the Librarian and Archivist of Canada, financial managers, financial officers and clerks) in the discharge of their responsibilities for financial reporting and maintenance of effective internal control over financial reporting.

While the “in-scope” elements above support the broader implementation of the Policy on Internal Control, the audit opinion focuses on LAC’s readiness to implement the policy requirements for an assessment of ICFR.

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<sup>1</sup> *Policy on Internal Control* stated objective: to ensure that risks related to stewardship of public resources are adequately managed through effective internal controls, including internal control over financial reporting. See <http://www.tbs-sct.gc.ca/pol/doc-eng.aspx?id=15258>

## Approach and Criteria

We used a standard audit process, based on professional standards that are in compliance with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing. For each of the control areas above, specific audit criteria and sub-criteria were identified. The details of the methodology and criteria used are presented in Appendix A and Appendix B.

### 1.3 Summary of Findings

To meet the Policy on Internal Control requirements, LAC is expected to develop, and execute annually, a risk-based plan to assess the effectiveness of their internal controls over financial reporting. To this end, the CFO has assigned the Manager, Financial Policies, Management Practices and Quality Assurance to lead the ICFR assessment process, and together, they are developing the approach to be ready to meet the requirements of the *Statement of Management Responsibility including Internal Control over Financial Reporting* for the financial reporting year ending 2011–2012.

To support the achievement of this objective, the framework for the ICFR assessment process should include clear communication and documentation of roles and responsibilities and accountabilities for internal controls, including ICFR, to key stakeholders. In addition, regular communication and awareness training regarding controls and ICFR responsibilities, including the development of specified learning plans for key stakeholders is required. These actions have not yet been taken by the CFO.

The ICFR assessment process hinges on conducting a financial reporting risk assessment. While BAC's risk management practices are maturing; formal risk management practices are being established in key operational areas, analysis of risk is being integrated with annual and strategic planning and investments have been initiated to develop capacity through training and guidance documents, the organization has not yet established financial reporting risk management principles.

LAC has in place both formal and informal controls at the entity level, IT general controls and controls over key financial systems, and for key financial processes. Some formal controls are documented, but most controls are not documented or tested. LAC has not started the process of documenting controls or testing control design and effectiveness.

To carry out the ICFR assessment, LAC will need to select a control framework against which to assess and report on the effectiveness of

entity-level controls in relation to key risks facing LAC's financial reporting. LAC will also need to identify on a risk basis, the key IT general controls and financial system and process controls to document and assess for the appropriateness of the design and effectiveness of the control in supporting financial reporting.

In addition to these findings, observations of conditions that were non-systemic and of low materiality and risk have been communicated to management for their consideration.

## 1.4 Recommendations

The report identifies the following recommendations. Management has agreed and developed an action plan to address these recommendations.

### **RECOMMENDATION 3.1 (See section 3):**

The CFO ensures that:

- a) An assessment framework is developed and documented that clearly outlines the risk-based approach the organization will take to assess its internal controls.
- b) Roles, responsibilities and accountabilities for internal controls over financial reporting and ICFR assessment process are well documented, communicated and acknowledged by key departmental governance and advisory bodies, senior departmental managers, including the Chief Audit Executive, and all staff in the Finance and Accommodation Branch.

### **RECOMMENDATION 3.2 (See section 3):**

The CFO develops a framework for assessing ICFR that includes documenting the organization's approach to assessing and managing risks related to financial reporting.

**RECOMMENDATION 3.3.1 (See section 3):**

The CFO, in consultation with the Chief Audit Executive, selects a framework to structure the ICFR assessment of entity-level controls.<sup>2</sup>

**RECOMMENDATION 3.3.2 (See section 3):**

The CFO develops a plan to assess risks within the “in-scope” IT general controls to determine the nature and extent of testing required.

**RECOMMENDATION 3.3.3 (See section 3):**

The CFO develops a plan to identify key process level controls and assess the risks related to the “in-scope” financial processes and key financial systems, and the CFO determines the nature and extent of documenting and testing required.

**RECOMMENDATION 3.4 (See section 3):**

The CFO defines training plans and awareness requirements in internal control areas to support key stakeholders in their roles and responsibilities for deploying the Policy on Internal Control.

## 1.5 Overall Conclusion

The assessment is that LAC has started the planning phase of the assessment process, and significant work is required to implement the processes and practices needed to complete the remaining phases of the assessment process and comply with the Policy on Internal Control requirements for the *Statement of Management Responsibility, including Internal Control over Financial Reporting* by 2011–2012.

The CFO has assigned the Manager, Financial Policies, Management Practices and Quality Assurance to lead the assessment planning process. Together, they are in the process of developing the approach.

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<sup>2</sup> *Policy on Internal Control*, paragraph 3.2: Numerous frameworks have been developed by various professional associations and bodies relating to internal control. One widely recognized framework is that of the *Committee of Sponsoring Organizations of the Treadway Commission* (COSO).



## 2 BACKGROUND

### 2.1 Policy on Internal Control—Overview

The Policy on Internal Control does not introduce new controls or require more controls; rather the policy aims to improve the consistency in how internal controls are managed.

The Policy on Internal Control took effect April 1, 2009, and reaffirms the responsibility of the Deputy Head, as accounting officer, for ensuring the maintenance of effective risk-based systems of internal control in the following broad areas: effectiveness and efficiency of programs; operation and resource management; safeguarding of assets; reliability of financial reporting; compliance with legislation, regulation, policies and delegated authorities.<sup>3</sup>

The Policy on Internal Control does not introduce new controls or require more controls; rather the policy aims to improve the consistency in how internal controls are managed and supported by appropriate risk-based information.

The Policy on Internal Control seeks to:

- clarify roles and responsibilities (raising awareness and understanding) for the establishment, use, maintenance and ongoing monitoring of effective departmental systems of internal control that are balanced with and proportionate to the risks they mitigate;
- bring consistency and rigour on how internal controls over financial management and financial reporting are managed to support continuous improvement through, in particular, periodic assessments;
- strengthen accountability and transparency for internal controls over financial reporting (ICFR) through the release of an annual *Statement of Management Responsibility Including Internal Control over Financial Reporting* signed by the Deputy Head and his or her Chief Financial Officer (CFO), and that is supported by appropriate evidence obtained annually from the execution of an assessment of the effectiveness of the departmental system of internal control over financial reporting;
- enable the implementation and maintenance of controls that are balanced with and proportionate to the risks they aim to mitigate, based on the results of, and information provided through, ICFR assessments.

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<sup>3</sup> *Financial Administration Act*, paragraph 16.4(1)(b)

## 2.2 Statement of Management Responsibility

LAC must be ready to meet the requirements of the *Statement of Management Responsibility Including Internal Control over Financial Reporting* for the year ending 2011–2012.

In the Canadian federal government, Deputy Heads have always had the responsibility to ensure that internal controls are regularly reviewed in the context of risk, ensuring that those internal controls are balanced against and proportional to the risks they mitigate. Deputy Heads and their CFOs sign an annual letter of representation to the Auditor General and the Deputy Receiver General in support of the Public Accounts covering their responsibilities for internal control and assertions over the integrity of financial information.<sup>4</sup>

One of the requirements flowing from the Policy on Internal Control is the revised *Statement of Management Responsibility Including Internal Control over Financial Reporting*. This statement, signed by the Deputy Head and the CFO, will preface the departmental financial statements and will acknowledge management's responsibility for:

- ensuring the maintenance of an effective system of internal control over financial reporting;
- conducting an annual risk-based assessment of the effectiveness of the departmental system of internal control over financial reporting;
- establishing an action plan to address any weaknesses identified;
- including a summary of assessment results and the action plan (showing progress from previous years) as an annex to the financial statements.

The *Statement of Management Responsibility Including Internal Control over Financial Reporting* will be implemented by departments, in clusters, over a three-year period from 2009–2010 through 2011–2012.<sup>5</sup> LAC must be ready to meet the requirements of the Statement for the year ending 2011–2012.

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<sup>4</sup> *Policy on Internal Control*, paragraph 3.4

<sup>5</sup> *Policy on Internal Control*, paragraph 1.2

## 2.3 Internal Control over Financial Reporting

Internal control over financial reporting (ICFR) is a sub-set of the broader system of internal control. Financial reporting refers to financial reports and disclosures that are both internal and external to a department. ICFR operate to provide reasonable assurance regarding the reliability of financial information and statements prepared for internal and external purposes. ICFR is intended to help ensure the integrity and usefulness of the financial statements.

ICFR helps provide management and users of financial statements with an understanding that:

- the organization maintains records that fairly reflect all financial transactions;
- transactions are recorded in accordance with applicable policies, directives and standards;
- transactions are carried out in accordance with delegated authorities;
- unauthorized transactions that could have a material effect on financial information and financial statements are prevented or detected in a timely manner;
- financial resources are safeguarded against material loss due to waste, abuse, mismanagement, errors, fraud, omissions and other irregularities;
- appropriate processes exist to review the effectiveness of internal control over financial reporting.

The annual assessment contemplated in the Policy on Internal Control is intended to be a management self-assessment process led by the CFO and supported by senior departmental managers (i.e., managers reporting directly to the Deputy Head).<sup>6</sup> This requires the development and execution of a risk-based multi-year assessment plan to guide the assessment of the effectiveness of the design and operation of key controls over financial reporting. The pace and scope of the multi-year assessment plans are also based on risk. Each annual assessment can be considered a component of the multi-year assessment plan that is developed based on the following:

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<sup>6</sup>In the context of Library and Archives Canada, this includes: ADM Corporate Management Sector, ADM Documentary Heritage Collection Sector, ADM Programs and Services Sector, Corporate Secretary, Chief Financial Officer, DG Communications, and Senior Advisor. While the Chief Audit Executive (CAE) reports to the Deputy Head, the role of the CAE in the annual assessment is to provide assurance in relation to the department's system of internal control, including as this relates to financial reporting. This is done by means of the risk-based audit work of the internal audit function and through work designed to support a more holistic view on departmental governance, risk management, and control arrangements.

- identifying key risks relevant to the department's financial reporting;
- identifying the core financial processes and controls that correspond to key risks identified;
- planning the scope and expected timing of the assessment of these key controls over the multi-year planning horizon. The scope, timing and extent of testing required can be determined based on:
  - the department's risk profile and priorities
  - the size, complexity and maturity of its operations
  - the extent to which results from other assessments, audits, and other central agency reports may be leveraged
  - departmental capacity

The results of the annual assessment and action plan are to be summarized in an annex to the *Statement of Management Responsibility Including Internal Control over Financial Reporting*. In this summary, the Deputy Head and the CFO will provide a description of significant findings of the ICFR assessed in the given fiscal year per the assessment plan and management's plans to address any significant gaps or weaknesses identified.

### 3 FINDINGS, RECOMMENDATIONS AND MANAGEMENT RESPONSE

To meet the Policy on Internal Control requirements, Library and Archives Canada (LAC) is expected to develop and execute annually, a risk-based plan to assess the effectiveness of its internal controls over financial reporting. Accordingly, the audit has assessed the adequacy of processes and practices in place to support the deployment of the Policy on Internal Control requirement to assess Internal Control over Financial Reporting (ICFR) related to external financial statements. This section presents detailed findings based on the evidence and analysis from both the initial risk analysis and the detailed audit conduct.

#### 3.1 Governance and Accountability

As set out in the Policy on Internal Control, the Deputy Head has overarching responsibility for the departmental system of internal control, including internal control over financial reporting. These responsibilities are, however, reliant upon assurance provided from other key positions related to internal control in the department.

**FINDING 3.1.1: The CFO has assigned the Manager, Financial Policies, Management Practices and Quality Assurance to lead the ICFR assessment process, and together, they are developing the approach to meet the requirements of the *Statement of Management Responsibility including Internal Control over Financial Reporting* for the financial reporting year ending 2011–2012.**

The framework for conducting a risk-based assessment of the effectiveness of internal control over financial reporting is comprised of five phases: (1) planning, (2) evaluating entity-level controls, (3) evaluating process-level controls, (4) testing control design and operating effectiveness; and (5) concluding on testing results, reporting and developing an action plan.

LAC has started the planning phase of the assessment process, and significant work is still required to implement the processes and practices required to comply with the Policy on Internal Control requirements for the *Statement of Management Responsibility, including Internal Control over Financial Reporting* by 2011–2012. The CFO has assigned the Manager, Financial Policies, Management Practices and Quality Assurance to lead the assessment planning process.

The purpose of developing a framework for the risk-based ICFR assessment process is to enable a manageable and sustainable approach to meeting the Policy on Internal Control requirements. Proper planning will help to focus the ICFR assessment on the areas of most significance, or risk, to the department's financial statements, identify control testing that can be relied upon to reduce duplication of effort and

unnecessary work, and ensure the assessment activities can be completed over the planned assessment timeframe.

Management was provided with additional guidance on how to plan and execute the ICFR assessment by the consulting firm.

**FINDING 3.1.2: In support of the implementation of the PIC, and the ICFR assessment process, there is a need for communication and documentation of roles, responsibilities and accountabilities for internal controls, including ICFR, to key stakeholders. The CFO has not yet clearly communicated or documented these roles, responsibilities and accountabilities.**

The Deputy Head must be supported by key internal parties and advisory committees (such as the Departmental Audit Committee) who have specific roles and responsibilities for maintaining and reviewing the effectiveness of the LAC system of IFRC.

The implementation of the Policy on Internal Control within LAC is in its infancy, and communication of responsibilities and accountabilities for internal control, including ICFR has not yet taken place.

The consulting firm provided management with additional guidance on roles and responsibilities for key internal parties, including senior departmental managers, the Chief Audit Executive and the Departmental Audit Committee.

Communicating ICFR roles and responsibilities to the people upon whom the Deputy Head and CFO will rely for assertions on the state of internal controls within the department will establish a common knowledge and understanding of responsibilities to maintain and monitor the system of internal control over financial reporting. If the key parties—who will enable this process—are not adequately briefed on their responsibilities, there is a risk that the ICFR assessment process will be inefficient and ineffective.

**RECOMMENDATION 3.1:**

The CFO ensures that:

- a) An assessment framework is developed and documented that clearly outlines the risk-based approach the organization will take to assess its internal controls.
- b) Roles, responsibilities and accountabilities for ICFR and assessment processes are well documented, communicated and acknowledged by key departmental governance and advisory bodies, senior departmental managers, including the Chief Audit Executive, and all staff in the Finance and Accommodation Branch.

#### MANAGEMENT RESPONSE:

Management agrees with the recommendation. The risk-based approach that the organization will use to assess its internal controls will be determined in the months to come. As the implementation of the policy on internal controls evolves, we will develop the assessment approach documentation for risk-based controls. This assessment approach—that will establish among other things the roles and responsibilities at various levels in the institution—will be developed in co-operation with the stakeholders involved in the approach. The approach will be submitted to senior management and to the appropriate advisory committees for their review, comments and approval.

### 3.2 Risk Management

The ICFR assessment process hinges on conducting a financial reporting risk assessment.

As a first step, LAC would need to identify and analyze risks to the achievement of financial reporting objectives as a basis for determining how the risks should be managed.

#### **FINDING 3.2: Financial reporting risk-management principles have not been established**

Broadly speaking, financial reporting risk relates to anything that threatens the department's ability to produce reliable financial information and financial statements for internal and external reporting purposes.

For financial reporting purposes, the risk-assessment process includes how management identifies risk relevant to producing reliable financial information and financial statements, estimates their significance, assesses the likelihood of their occurrence, and decides what actions are required to manage them. The general process is: understand financial reporting objectives; identify financial reporting risk areas; assess financial reporting risks; risk response—implementation of financial reporting risk control strategy; and monitor, evaluate and revise financial reporting risk strategies.

The CFO and Manager, Financial Policies, Management Practices and Quality Assurance are in the process of developing the approach for conducting the assessment. They have not defined the LAC financial reporting objectives, neither have they identified or assessed financial reporting risks, nor have they implemented risk-monitoring strategies.

The ICFR assessment process hinges on conducting a financial reporting risk assessment. The consulting firm provided management with guidance from the Canadian Institute of Chartered Accountants handbook regarding financial statement assertions/reporting objectives, and a tool for identifying financial reporting risk areas.

The absence of a systematic and documented approach to financial reporting risk management could result in an ineffective approach to the ICFR assessment process.



#### RECOMMENDATION 3.2:

The CFO develops a framework for assessing ICFR that includes documenting the organization's approach to assessing and managing risks related to financial reporting.

#### MANAGEMENT RESPONSE:

Management agrees with this recommendation. During the implementation of the policy on internal controls, we will develop a risk matrix on financial reports. When the matrix is established, management will adopt an approach that will help assess, review and manage risks related to financial reports and thus periodically update the risk matrix.

### 3.3 Stewardship

Experience from public and private sector organizations both in Canada and internationally has shown that one of the key success factors to an efficient and cost-effective ICFR assessment is the adoption of a top-down and risk-based approach.

#### **FINDING 3.3.1: A control framework has not been selected against which to assess and report on the effectiveness of entity-level controls in relation to key risks facing LAC's financial reporting.**

Entity-level controls set the tone and broad expectations for the manner in which a department or agency will pursue its objectives, and as such, have a pervasive influence throughout the department.

While we found that many entity controls exist at LAC, formally and informally, the CFO indicated that a control framework has not yet been selected for the ICFR assessment process. Management was provided with additional guidance on control frameworks by the consulting firm.

If entity-level controls are weak, inadequate, or nonexistent, they can create weaknesses in controls at the process level, and ultimately, impact the department's ability to achieve its goals and objectives. When operating effectively, entity-level controls directly support the department's ability to manage its strategic and operational risks, and thus achieve its various departmental objectives and may reduce the nature, timing and extent of detailed control testing required within financial processes and IT systems.

Also, using a well-structured and comprehensive assessment framework will verify coverage and completeness of the ICFR assessment, and support defensibility of ICFR conclusions.



### RECOMMENDATION 3.3.1:

The CFO, in consultation with the Chief Audit Executive, selects a framework to structure the ICFR assessment of entity-level controls.<sup>7</sup>

### MANAGEMENT RESPONSE:

Management agrees with this recommendation. The CFO, in consultation with the Chief Audit Executive, will establish a framework for the assessment of the controls at the institutional level.

Once the organization wide control environment or entity level is understood and assessed, controls are further identified and tested at two primary levels: IT general controls and the financial process level.

### FINDING 3.3.2: Key financial systems have been identified and some, but not all, key IT general controls related to these systems have been documented; however these controls have not been assessed for the appropriateness of the design or effectiveness of the control in supporting financial reporting.

Information technology general controls are controls that impact the IT environment, such as access to programs and data, program changes, program development, and computer operations.

Key financial systems in use by LAC include: FreeBalance Financial Systems; FreeBalance Performance Budgeting for Human Capital; and AMMIS system for capital asset tracking. The Financial Systems Group is responsible for maintaining FreeBalance (manage application-level security and daily back-up), with some additional support from the IT Branch. For example, the entity-wide security program is run by IT Branch.

The 2008 Internal Audit Review of Privacy report observed that LAC's security infrastructure shows some strengths and weaknesses. The review noted several strengths in relation to the security measures to properly safeguard personal information, including secure server location, intrusion prevention system, firewall access rules, ad hoc monitoring of the use of computers by employees, security threat and risk assessment conducted when the system is storing Protected A or higher information,<sup>8</sup> and a security training program for employees.

In addition, LAC's Round VI MAF Assessment and Action Plan 2009–2010 for Area of Management 19—Effective Management of Security and Business Continuity includes pursuing ongoing initiatives to continue improving the departmental security program, including communications

<sup>7</sup> *Policy on Internal Control*, paragraph 3.2: Numerous frameworks have been developed by various professional associations and bodies relating to internal control. One widely recognized framework is that of the *Committee of Sponsoring Organizations of the Treadway Commission* (COSO).

<sup>8</sup> Through interviews with Finance and Accommodation Branch, we were advised that a security threat and risk assessment has not been conducted on the key financial systems.

and roll-out of the new security policy to be in alignment with the Government Security Policy.<sup>9</sup>

IT general controls in relation to FreeBalance Financial Systems, such as authorized users, application software development and change controls, system software controls (such as user classes, password access controls), segregation of duties, and business continuity plans were all identified by interviewees as being in place. Some of these controls have been documented; however, they have not been tested.

In terms of the ICFR assessment process, IT general controls related to these key financial systems should be documented and assessed for the appropriateness of the design or effectiveness of the control. For LAC to rely on automated controls to support the achievement of its financial reporting objectives, relevant IT general controls for related underlying systems must be designed and operating effectively.

#### **RECOMMENDATION 3.3.2:**

The CFO develops a plan to assess risks within the “in-scope” IT general controls to determine, using a risk-based approach, the nature and extent of testing required.<sup>10</sup>

#### **MANAGEMENT RESPONSE:**

Management agrees with this recommendation. When computer controls are available to support the institution's control framework, they will be used to improve the efficiency of the control systems. The nature and scope of the computer control tests will then be established based on risk assessment.

Internal controls are required around the key financial statement process cycles and the significant accounts within each process.

Process level controls mitigate the risks threatening the execution of individual transactions and provide assurance that transaction objectives are achieved.

#### **FINDING 3.3.3: Key transaction-level controls for “in-scope” financial processes have not been documented, nor has the effectiveness of the design or operation of the controls been tested.**

Internal controls (automated IT application controls as well as manual controls) are required around the key financial statement processes and significant accounts within each process to ensure transactions are authorized, complete, accurate, valid and timely processed.

The CFO and the Manager, Financial Policies, Management Practices, Quality Assurance identified the significant accounts on LAC's external financial statements (capital assets, purchases/payables,

<sup>9</sup> The MAF Round VII assessment may result in changes to the initiatives and action plan for Area of Management 19 – Effective Management of Security and Business Continuity.

<sup>10</sup> When assessing IT general controls, LAC should refer to the Control Objectives for Information and Related Technology (COBIT) framework to identify the IT control objectives that are considered significant or “in-scope” for IT systems. The COBIT framework is a set of best practices for the management of IT governance, risk and control. The COBIT framework is widely used in both the private and public sectors as a framework or source of reference against which IT general controls can be assessed. The framework describes control objectives and criteria within a number of categories, including systems development, access to programs and data, change management, security, and computer operations.

receivables/revenue and payroll), however, the next step of identifying, documenting and testing key controls for these “in-scope” financial processes has not been executed.

LAC has designed procedures, practices and processes to ensure that the financial data, books of account and financial reports are complete, accurate and prepared on a timely basis, for example:

- LAC has established, documented and clearly communicated its general accounting policies.
- The organization has defined its requirements for accounting records and has implemented FreeBalance Financial Systems as its general accounting system to record transactions and meet its accounting requirements. This system incorporates control activities that ensure that LAC’s financial data are complete, accurate and authorized.
- Procedures are established and responsibilities are assigned for processing accounting transactions such as accounts payable, payroll, accounts receivable, and revenue.
- General accounting activities (e.g., recording transactions, issuing payments, maintaining accounting records, preparing financial reports) are performed on a regular basis.
- Processing and control over payment authorization is centralized in Accounting Operations.<sup>11</sup>
- Financial Officers in the Finance and Accommodation Branch are available to provide functional guidance and advice for managers in carrying out their financial activities.
- Standard period-end procedures with respect to Payables at Year End are communicated to salary administrators, account verification personnel and financial advisors.

LAC has not documented these controls, nor has it put in place testing and monitoring procedures of the design and operating effectiveness of these financial process controls.

Process-level controls mitigate the risks threatening the execution of individual transactions and provide assurance that transaction objectives are achieved. In the absence of these controls (or in the absence of testing and monitoring these controls, on a risk basis), there is a risk that the goal of ensuring financial data, books of account and financial reports are complete, accurate and prepared on a timely basis may not be achieved.

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<sup>11</sup> Accounting Operations processing and control over payment authorization includes 100 percent verification of expenditure initiation (s. 32) and s. 34 approvals, and matching the invoice to source documents. Once the review of compliance with regulations and policies, and application of appropriate financial controls is complete, the financial officer in accounting operations then exercises s.33 approval.

### RECOMMENDATION 3.3.3:

The CFO develops a plan to identify key process-level controls and assess the risks related to the “in-scope” financial processes and key financial systems, and the CFO determines the nature and extent of documenting and testing required.

### MANAGEMENT RESPONSE:

Management agrees with this recommendation. The implementation of the internal control policy will be undertaken progressively using an approach based on financial report risks as required by the Treasury Board. In the months to come, we will proceed with the assessment of the financial report risks and then the implementation plan will be developed in line with the risk assessment. The plan will establish the key control systems that will have to be documented, reviewed and assessed as well as the scheduled deadlines.

## 3.4 People

Training and regular refreshers with respect to policies, processes and practices (including roles and responsibilities) for key stakeholders in the ICFR process will equip them with the necessary skills to support the Deputy Head and the CFO in making assertions on the state of internal controls within the department.

### FINDING 3.4.1: There is a need for more frequent and regular communication and awareness training regarding controls and ICFR responsibilities, including the development of specified learning plans for key stakeholders.

Training, tools and resources are needed to support various parties (CFO, Chief Audit Executive and other senior managers reporting to the Librarian and Archivist of Canada, responsibility centre managers, financial managers, financial officers and clerks) in the discharge of their responsibilities and accountabilities for internal control, including ICFR. This includes regular communication and reminders of the key policies, processes, and practices (including roles and responsibilities) to maintain and keep current the knowledge of key stakeholders about controls, including controls over financial reporting. In addition, training plans are a key step in acquiring essential skills, and it is important to ensure the implementation of those plans.

Training is available (formal training and informal knowledge transfer) for managers and non-managers to help them fulfill their duties. The review of training material delivered to Administrative Services staff and responsibility centre managers confirmed that training is available in FreeBalance Financial Systems modules and in FreeBalance Performance Budgeting for Human Capital, as well as other financial management processes such as financial planning, delegation of authority, contracting and the procurement process, as well as accounting operations.

In addition, there was consensus among Financial Officers and Administrative Services staff that opportunities for knowledge transfer exist (internal training, lunch-and-learn sessions, on-the-job training), however this group of employees also noted that there are often time constraints, budget constraints or other circumstances that prevent them from taking or receiving training.

In interviews, senior managers noted job-related training is available and encouraged. However, most of the senior managers interviewed agreed that there is a need for regular communication and awareness training regarding controls and ICFR responsibilities and accountabilities.

Learning plans in internal control areas to support these various parties in their roles and responsibilities for deploying the Policy on Internal Control have not been established.

Identifying necessary training and regular refreshers with respect to controls, including controls over financial reporting, for key stakeholders in the ICFR process will equip them with the necessary skills to support the Deputy Head and the CFO in making assertions on the state of internal controls within the department. In absence of this, senior departmental managers may establish, maintain, and monitor the system of internal control, including internal controls over financial reporting, in the programs for which they are responsible, inconsistently and ineffectively. There is also a risk that employees will not be appropriately trained in the principles, values, practices and behaviours considered appropriate to conduct LAC's business.<sup>12</sup>

#### **RECOMMENDATION 3.4:**

The CFO defines training plans and awareness requirements in internal control areas to support key stakeholders in their roles and responsibilities for deploying the Policy on Internal Control.

#### **MANAGEMENT RESPONSE:**

Management agrees with this recommendation. As part of the establishment of an appropriate control environment, specific and general training will have to be developed to help the various stakeholders understand and properly assume their roles and responsibilities as regards controls at the unit level.

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<sup>12</sup> The following internal control areas will be integral to the training: organizational values and principles, code of conduct, business ethics and compliance standards, legislative and regulatory requirements, basic accounting policies and procedures, central agency directives and guidelines, risk assessment, training on financial systems, understanding control frameworks and process controls, and training in planning and budgeting activities.

## Appendix A AUDIT APPROACH

### METHODOLOGY

A standard audit process was used, based on professional standards that are in compliance with the Institute of Internal Auditors' Standards for the Professional Practice of Internal Auditing. The approach, which includes planning, fieldwork and reporting phases, is summarized below.

### PLANNING PHASE

During the planning phase, an understanding of Library and Archives Canada's (LAC) financial management environment was developed through preliminary interviews with the Director General, Finance and Accommodation/Chief Financial Officer and key managers in the Finance and Accommodation Branch. Relevant documentation was also reviewed, including:

- LAC Risk-based Audit Plan (2009–2012)
- MAF Assessment (Round VI), Action Plan (Round VI), Self-Assessment (Round VII) for the following relevant areas of management: Values-based leadership and organizational culture; effectiveness of corporate management structure; corporate risk management; effectiveness of asset management; effective project management; effective procurement; effectiveness of financial management and control; and effectiveness of internal audit.
- LAC Governance Structure
- Terms of Reference for various governance committees with financial control oversight responsibilities, including the Departmental Audit Committee, the Management Board, Infrastructure Planning Advisory Committee, Digital Information and Technology Steering Committee, Collection Storage Facility Finance Committee, Nitrate Film Facility Finance Committee, Contract Review Committee
- LAC organizational structure, Finance and Accommodation Branch organizational structure (current), Finance and Accommodation Branch organizational structure (proposed)
- LAC financial statements for the year ending March 31, 2009
- Corporate Dashboard and explanation
- Delegation of financial authority and designation order with delegation charts

- Work descriptions and task lists for various levels of financial officers and clerks in accounting operations.
- Year-end procedures for the FreeBalance payables module
- Implementing the Policy on Internal Control, presentation to FMI PD Week participants, November 2009, by Sharon Smith, TBS-OCG, Director, Financial Operations.

This information helped identify inherent risks to which the processes that support the Internal Control over Financial Reporting (ICFR) assessment are exposed.

Working with the list of inherent risks, we identified key controls and associated audit criteria to address the audit. The audit criteria are set out in Appendix B.

## FIELDWORK PHASE

During the fieldwork phase, the audit program was executed. The methodology consisted of:

- Document Review—Reviewing relevant documentation in support of controls in place over the ICFR assessment process, including:
  - A sample of agendas and minutes of key governance committees taken from the last six months.
  - LAC's hospitality policy, as an example of a financial policy
  - Internal Audit's *Audit of Risk Management Report and Review of Privacy Report*
  - FreeBalance functional classes matrix
  - Examples of aide-memoire pieces on topics related to accounting operations procedures in FreeBalance
  - Examples of internal training provided on topics related to accounting operations, financial planning, resource management, and contracting and material management.
- Interviews with staff—18 interviews were conducted; the sample of interviewees was drawn to give a good cross-representation of senior departmental managers, Finance and Accommodation Branch managers and financial officers, and the administrative services level.

## REPORTING PHASE

Management of the auditable entity was given the opportunity to comment on the draft report.

This report was recommended by the members of the Departmental Audit Committee for approval by the Deputy Head.



## Appendix B AUDIT CRITERIA

Taken collectively, the control framework below defines an adequate and effective system of control to support the deployment the risk-based assessment of ICFR. The control framework has been developed using inputs from the draft Core Management Control Model of the Office of the Comptroller General of Canada, COSO, Internal Control over Financial Reporting—Guidance for Smaller Public Companies, Executive Summary, Volume 1, audit criteria from the Audit of Readiness Assessment of Controls for External Audit of Public Service Commission Financial Statements (November 2006), and the Office of the Auditor General Financial Management Capability Model.

Control Element	Audit Criteria	Sub-Criteria
Governance and Accountability	1 Effective oversight bodies are established with a clearly communicated mandate that includes roles with respect to governance, risk management and control.	<ul style="list-style-type: none"> <li>• A documented mandate (in the form of a charter or other documentation) exists and clearly communicates the oversight bodies' roles and responsibilities related to governance, risk and control.</li> <li>• (Scope: Management Board and Departmental Audit Committee )</li> </ul>
	2 The oversight bodies request and receive relevant, reliable and timely risk-based information on risk and controls.	<ul style="list-style-type: none"> <li>• There is ongoing and transparent communication among the oversight bodies, the management and the Deputy Head on the subject of relevant, reliable and timely risk-based information about risk and controls, including ICFR.</li> <li>• (Scope: Management Board, Departmental Audit Committee, Finance and Accommodation Branch Committees (Contracting, Collection Storage, Nitrate Film Facility Finance Committee, Contract Review Committee)</li> </ul>

Control Element	Audit Criteria	Sub-Criteria
	3 Authority, responsibilities and accountabilities for internal control, including ICFR are clearly articulated and understood by stakeholders.	<ul style="list-style-type: none"> <li>The organizational structure permits clear and effective lines of communication and reporting in support of ICFR. For example, established reporting relationships (formal and informal, direct and indirect), provide managers information appropriate to their responsibilities and authority.</li> <li>Employees' duties and control responsibilities are clearly defined.</li> </ul>
Risk Management	4 LAC has identified a risk-assessment process to support the identification of key processes and controls that need to be tested in support of the ICFR assessment.	
Stewardship Entity-Level Controls	5 The organization has selected a core control framework against which it can assess the effectiveness of its control environment.	<ul style="list-style-type: none"> <li>The organization has in place systems, processes and activities at the entity level (i.e., those controls that are pervasive across the entire organization) to support the achievement of its objectives.</li> </ul>
Stewardship IT General Controls	6 LAC has designed a process to test and report on IT general controls that support financial reporting requirements.	
Stewardship Process or Transaction Level Controls	7 LAC has designed a process to test and report on application controls that ensure financial data recorded, processed and reported is authorized, complete, accurate and valid.	
	8 LAC has designed procedures, practices, and processes to ensure that financial data, books of account and financial reports are complete, accurate and prepared in a timely manner.	
People	9 LAC provides key governance bodies, senior management and employees with the necessary training, tools, and resources to support the discharge of their ICFR responsibilities.	